

Senate Fiscal Agency
P. O. Box 30036
Lansing, Michigan 48909-7536

SFA**BILL ANALYSIS**

Telephone: (517) 373-5383
Fax: (517) 373-1986
TDD: (517) 373-0543

Senate Bill 1418 (as reported without amendment)
Sponsor: Senator Bill Bullard, Jr.
Committee: Financial Services

Date Completed: 10-7-02

RATIONALE

The Michigan Limited Liability Company Act was enacted in 1993 to recognize a relatively new type of business entity. A limited liability company (LLC) has features of both a corporation and a partnership. Like a corporation, an LLC provides its "members" (those with an interest in the company) with protection against personal liability for the debts of the business. At the same time, an LLC offers the more advantageous tax treatment of a partnership, as well as flexibility in structuring the company's internal organization, management, and procedure. This type of business formation has become increasingly popular. According to the Business Law Section of the State Bar of Michigan, which was instrumental in drafting the original statute, more LLCs than corporations have been formed in the last two fiscal years.

In 1997, the Business Law Section also helped draft amendments to the Act. These added flexibility to the law in response to changes in Federal tax regulations, and revised various provisions regarding LLCs' organization and operation. Among other things, the 1997 amendments eliminated a requirement that an LLC be organized and operated by at least two members. Unlike other LLCs, however, single-member LLCs may not enter into operating agreements, which govern the affairs of an LLC and the conduct of its business. It now appears that most businesses would prefer to have operating agreements, and financial institutions expect to see these agreements when making loans to LLCs. Other issues that have arisen since 1997 involve a requirement that members make a contribution to an LLC, which evidently can be problematic in some situations, and potential confusion about the manner in which a husband and wife may hold a membership interest in an LLC.

Another concern involves the failure of many LLCs to file annual statements with the Michigan Department of Consumer and Industry Services (DCIS). Under the Act, an LLC must file an annual statement containing the name of its resident agent and the address of its registered office in this State. A professional limited liability company (an LLC formed to render one or more professional services) must file an annual report listing the names and addresses of all members and managers and certifying that each one is a licensed person in one or more of the professional services rendered by the company. The Act also requires LLCs to pay a filing fee with each annual statement or annual report, and imposes a penalty on professional LLCs whose reports are late. Other than that penalty, the Act prescribes no consequences for failure to file. As a result, many LLCs evidently do not file statements or reports, which means that the filing fees are not paid, either.

It has been suggested that these issues be addressed by amendments to the Act.

CONTENT

The bill would amend the Michigan Limited Liability Company Act to do the following:

- **Allow a single-member LLC to have an operating agreement.**
- **Allow a person to become a member of an LLC without contributing to the company.**
- **Provide that an LLC would be entitled to a certificate of good standing from the DCIS, unless the LLC failed to file its required annual statements for two consecutive years.**

- **Allow an LLC to obtain a certificate of restoration of good standing by filing its annual statements and unpaid fees, as well as paying a \$50 fee for the certificate.**
- **Provide that an LLC that was not entitled to a certificate of good standing could continue to transact business, although its name could be used by another entity.**
- **Specify that a husband and wife could hold a membership interest in joint tenancy in the same manner and subject to the same consequences and conditions that apply to the ownership of real estate held jointly by a husband and wife, with full right of survivorship.**
- **Prescribe the allocation of voting rights if a membership interest were held by two or more people.**
- **Provide for the electronic transmission and filing of documents, and allow the DCIS to charge a \$50 fee for documents filed or transmitted electronically.**
- **Make other changes regarding the organization, operation, and dissolution of an LLC, lawsuits against LLCs by members, and service of process.**

Organization

Single-Member LLC. The Act defines "operating agreement" as a written agreement of the members of a limited liability company having more than one member, as to the affairs of the LLC and the conduct of its business. The bill would refer to a written agreement "by the member of a limited liability company that has 1 member, or between all of the members of a limited liability company having more than 1 member".

The bill also states that an operating agreement of an LLC having one member would not be unenforceable because only one person was a party to the agreement.

Admission as Member. The Act provides that a member's contribution to an LLC may consist of property, cash, services, or a binding obligation to contribute cash or property or to perform services. The Act also provides for the enforcement of a promise to

make a contribution. The bill would retain these provisions, but also states that an LLC could admit as a member a person who did not make a contribution or incur an obligation to make a contribution to the company.

Nonmember Organizers. The Act provides that one or more persons, who will be members, may form an LLC by filing executed articles of organization. Under the bill, one or more persons, "who may or may not become members", could form an LLC.

Membership Interest; Husband & Wife. The Act states that a membership interest is personal property. The bill also states that a membership interest could be held in any manner in which personal property may be held. A husband and wife could hold a membership interest in joint tenancy in the same manner and subject to the same restrictions, consequences, and conditions that apply to the ownership of real estate held jointly by a husband and wife under the laws of this State, with full right of ownership by survivorship in case of the death of either.

Certificate of Good Standing

Domestic or Foreign LLC. The bill specifies that a limited liability company would be entitled to issuance by the administrator, upon request, of a certificate of good standing, except as otherwise provided. A domestic LLC would be entitled to the certificate from the effective date of the articles of organization until dissolution. A foreign LLC would be entitled to the certificate from the effective date of the certificate of authority to transact business in Michigan until withdrawal from the State. (The administrator is the DCIS Director or the Director's designee.)

A certificate of good standing issued to a domestic LLC would have to state that it had been validly organized as a domestic LLC, and that it was validly in existence under this State's laws. A certificate issued to a foreign LLC would have to state that it had been validly authorized to transact business in this State, and that it held a valid certificate of authority to do so. In both cases, the certificate also would have to state that the LLC had satisfied its annual filing obligations.

If a domestic or foreign LLC failed to file an annual statement for two consecutive years,

the administrator would have to notify the company of the consequences of the failure to file. If an LLC did not file all annual statements it had failed to file, and the applicable fees, within 60 days after this notice was sent, the company would not be in good standing and would not be entitled to issuance of a certificate of good standing. The company's name would be available for use by another entity filing with the administrator. The administrator could not accept for filing any document submitted by the LLC other than a certificate of restoration of good standing.

An LLC that was not in good standing would remain in existence and could continue to transact business in the State. The LLC could file a certificate of restoration of good standing, accompanied by the annual statements and fees for all of the years for which they were not filed and paid, and the fee for filing the certificate of restoration. The certificate would have to state that it was accompanied by those annual statements and fees. The certificate also would have to include the company's name at the time it ceased to be in good standing. If that name were not available when the certificate was filed, the LLC would have to select a new name. In addition, the certificate would have to include the name of the LLC's current resident agent and the address of the current registered office in this State.

The bill would establish a \$50 filing fee for a certificate of restoration of good standing.

Professional LLC. The bill contains generally the same provisions regarding a certificate of good standing for a professional limited liability company (PLLC), as proposed for a domestic or foreign LLC. The consequences for failure to file annual reports would be the same, and a PLLC could submit a certificate of restoration of good standing. A PLLC's certificate of restoration would have to be accompanied by the annual reports and fees for all of the years for which they were not filed and paid, as well as the penalty that is imposed when a PLLC fails to file its annual report by February 15.

Also, under the bill, the required annual report would be "in addition to the annual statement" that LLCs must file.

Name of LLC. Under the Act, the name of a domestic or foreign LLC must conform to certain requirements. Among other things, the name must be distinguished upon the administrator's records from the name of a domestic LLC or a foreign LLC authorized to transact business in this State. The bill would add, "that is in good standing".

The bill also specifies that the fact that an LLC name complied with the Act would not create substantive rights to the use of the name.

Voting Rights

The Act provides that an LLC's operating agreement may establish and allocate the voting rights of members, and may provide that certain members or groups of members have limited or no voting rights. If an operating agreement does not address voting rights, votes are allocated as prescribed by the Act. As a rule, each member of an LLC has one vote. The bill states that, for purposes of this provision, a membership interest held by two or more people, whether as fiduciaries, members of a partnership, tenants in common, joint tenants, tenants by the entirety, or otherwise, would be treated as held by one member.

Further, if a membership interest that had voting rights were held by two or more people, the voting of the interest would have to be in accordance with the instrument or order appointing them or creating the relationship, if a copy of that instrument or order were furnished to the LLC. If not, one of the following would apply:

- If an operating agreement applied to the voting of the membership interest, the vote would have to be in accordance with that agreement.
- If an operating agreement did not apply and only one of the people who held the membership interest voted, that person's vote would determine the voting of the interest.
- If an operating agreement did not apply and two or more of the people holding the membership interest voted, the vote of a majority would determine the voting of the membership interest; if there were no majority, the voting of the interest would be divided among those voting.

Currently, articles of organization are amended when a certificate of amendment is filed. The certificate must contain specified information, including a statement that the amendment or amendments were approved by the unanimous vote of all of the members entitled to vote or by a majority of the members entitled to vote if an operating agreement authorizes amendment of the articles by majority vote. The bill would refer to a vote by a "majority in interest", instead of a majority of the members entitled to vote. "Majority in interest" would mean a majority of votes as allocated by an operating agreement, or by the statute in the absence of an allocation by operating agreement, and held by members entitled to vote on a matter submitted for a vote by members.

Electronic Transmission

The Act provides that the administrator may establish procedures for accepting delivery of documents by means of facsimile transmission. Under the bill, the administrator also could establish procedures for accepting delivery by means of other electronic transmission.

The Act allows the administrator to reproduce documents and destroy the originals. A reproduced copy certified by the administrator, which may be sent by facsimile transmission, must be considered an original for all purposes and is admissible in evidence as an original. The bill also would refer to a reproduced copy sent by other electronic transmission.

The Act requires the administrator to give a person written notice of the administrator's refusal to file a document that has been submitted for filing. Under the bill, if the document were originally submitted by electronic transmission, the administrator could give the written notice in that manner.

Under the Act, if a filed document is inaccurate or was defectively or erroneously executed, a certificate of correction may be filed with the administrator. The bill also would allow a certificate of correction to be filed if a document were electronically transmitted and the transmission were defective.

The Act requires an LLC, upon a member's written request, to mail to the member a copy of the company's most recent annual financial statement and tax returns and reports. The bill would require an LLC to send a copy of these documents to the member by mail or electronic transmission.

The Act permits the administrator to charge a \$50 fee, in addition to the required filing fee, if a document is filed by facsimile transmission or the administrator is asked to transmit a document by facsimile. The bill also would allow the administrator to charge a \$50 fee for documents filed or transmitted by other electronic transmission.

The bill would define "electronic transmission" or "electronically transmitted" as any form of communication that met all of the following:

- It did not directly involve the physical transmission of paper.
- It created a record that could be retained and retrieved by the recipient.
- It could be directly reproduced in paper form by the recipient through an automated process.

Other Provisions

Resident Agent. The Act requires each domestic or foreign LLC to have and maintain in this State a resident agent upon whom any process, notice, or demand required or permitted by law to be served upon the company may be served. The bill specifies that, if an LLC failed to appoint or maintain an agent for service of process, or the agent for service of process could not be found or served through the exercise of reasonable diligence, service of process could be made by the delivery or mailing by registered mail to the administrator of a summons and copy of the complaint.

Under the Act, a person who is a member of an LLC or who accepts election, appointment, or employment as a manager of an LLC, by the acceptance, is held to have appointed the company's resident agent as his or her agent upon whom process may be served while the person is a member or manager, in any court action arising out of an action of the LLC or of a person as a member or manager of the company. Upon accepting service of process, the resident agent must forward it to the

member or manager. The bill would delete these provisions.

Manager's Authority to Act. Currently, an LLC is bound by the act of a manager that apparently carries on the company's business in the usual way, unless the manager does not have the authority to act for the company in that particular way and the person with whom the manager is dealing knows that he or she has no authority. Under the bill, a manager's act would not be binding upon the LLC if the person with whom the manager dealt had actual knowledge that the manager lacked the authority to act or the articles of organization or the statute established that the manager lacked the authority to act.

Member Lawsuit against LLC. Under the Act, a member of an LLC may bring an action in circuit court to establish that acts of the managers or members in control of the company are illegal or fraudulent, or constitute willfully unfair and oppressive conduct toward the LLC or the member. If the member establishes grounds for relief, the court may issue an order or grant relief as it considers appropriate, including an award of damages to the company or the member.

The bill provides that an action seeking an award of damages would have to be commenced within three years after the cause of action had accrued or within two years after the member discovered or reasonably should have discovered the cause of action, whichever occurred first.

The bill would define "willfully unfair and oppressive conduct" as a continuing course of action or a significant action or series of actions that substantially interfered with the interests of the member as a member. The term would not include conduct or actions permitted by the articles of organization, an operating agreement, another agreement to which the member was a party, or a consistently applied written company policy or procedure.

Dissolution. The Act states that an LLC is dissolved and its affairs must be wound up upon the first of the following: the time specified in the articles of organization; the happening of an event specified in the articles or in an operating agreement, including a vote of members; the unanimous vote of all

members entitled to vote; or the entry of a decree of judicial dissolution. The bill specifies that an LLC would be dissolved "automatically" at the time specified in the articles or upon the entry of a decree of judicial dissolution.

Currently, a certificate of dissolution must be signed and filed when an LLC dissolves and begins winding up. Under the bill, this requirement would not apply when an LLC was automatically dissolved.

MCL 450.4102 et al.

ARGUMENTS

(Please note: The arguments contained in this analysis originate from sources outside the Senate Fiscal Agency. The Senate Fiscal Agency neither supports nor opposes legislation.)

Supporting Argument

When the Act was amended in 1997 to permit single-member LLCs, these entities were not allowed to have operating agreements, which govern the way in which a business will be run. It was, and still is, considered illogical that a person could enter into an agreement with himself or herself. In practice, however, single-member LLCs would prefer to have operating agreements, and financial institutions expect to receive copies of these documents when doing business with LLCs. Therefore, it would make sense for Michigan, like other states, to allow single-member LLCs to have operating agreements. The practical demand for these agreements outweighs the academic point that they may be illogical.

Supporting Argument

At present, someone who wants to have a membership interest in an LLC is expected to make some kind of contribution, such as cash, property, or services, to the company. In some cases, however, the people who are organizing an LLC or who are members might wish to allow another party to become a member without making a contribution. This might occur, for example, if an LLC is undertaking a particular project that involves a nonprofit organization, and would like the organization's participation in carrying out the project. The organization might not have resources to contribute, or its contribution might not be needed. The bill would address this type of situation by allowing a party to have a membership interest in an LLC without making a contribution.

The bill also would allow someone to form an LLC even if he or she were not going to be a member. This would enable an attorney, for example, to organize limited liability companies on behalf of clients.

Supporting Argument

The bill would make it clear that husbands and wives could hold a membership interest in an LLC in the same manner in which they may own real estate or stock in a corporation. Under the law, married couples may own property as "tenants by the entirety". Based on the common law theory that a husband and wife are one person, this form of ownership has certain unique characteristics. When the Limited Liability Company Act was enacted, according to a representative of the State Bar Business Law Section, it was believed that a membership interest in an LLC could be entirety property. The Act apparently contains some ambiguity about this point, however. By clarifying the statute, the bill would remove the potential for misinterpretation.

Supporting Argument

According to figures of the DCIS, approximately 110,000 LLCs are responsible for filing a 2002 annual statement and paying the filing fee. Compliance with the requirement to do so apparently is mixed, since there are virtually no consequences for failure to file. The bill's provisions for a certificate of good standing would give the State some leverage to deal with LLCs that failed to file their annual statements for two years in a row. If an LLC were not in good standing, the DCIS could not file any documents from the company except a certificate of restoration of good faith, and the LLC's name could be taken by another entity. These provisions should encourage LLCs to file the required statements and reports, which would produce the filing fee revenue that is supposed to be paid.

In addition, if LLCs filed the required documents, the DCIS would have accurate and up-to-date information on the companies. Presently, without the statements and with no provision for a certificate of good standing, the DCIS cannot give helpful information to people who inquire about a particular company. These might include, for example, a potential lender or customer, a former employee, or someone who previously did business with the

company. Also, businesses that engage in financial or real estate transactions with corporations are accustomed to the good standing concept, and expect LLCs to have a certificate of good standing as well.

Response: If an LLC that was not in good standing continued to engage in business, while another entity took and used its name, people doing business with either company could be confused. Even though the original LLC would be responsible for losing its name, and have little cause to complain, the actual loser could be a member of the public.

Supporting Argument

The bill would bring the Act up to date by providing for the electronic transmission and filing of documents. This would benefit both LLCs and the DCIS, which would need to devote less time and space to filing and storing documents.

Response: It is not clear what would justify charging up to \$50 for electronically transmitting and filing documents, as the bill would allow. While the DCIS presently may charge up to \$50 for filing or transmitting documents by facsimile, the amount seems high.

Legislative Analyst: Suzanne Lowe

FISCAL IMPACT

The bill would establish a \$50 fee for the issuance of a certificate of restoration of good standing. The fee for a certificate of good standing would be \$10, according to a fee schedule established for the Corporation Division. There are currently 110,000 LLCs. Revenue would increase by \$1.1 million if each received a certificate of good standing. This revenue is restricted and used to administer the regulatory responsibilities in this division.

Fiscal Analyst: Maria Tyszkiewicz

A0102\S1418a

This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.